

confuse true economic profit with managerial wages. They should always make certain to plug in fair market wages for themselves and their management teams as an expense in projecting a firm's cash flows.

### Off balance sheet valuations

In the reality of business, the greatest values in a business often do not appear in the firm's financial statements. Only dollars are recorded by accountants, but dollars often fail to represent the true value of the enterprise. Such factors as the people who work for the company, its distribution system, its patents and research, the economic setting in which the company operates, the location of its real estate, and other hidden values are often the true assets that potential buyers are most interested in acquiring.

In the reverse instance, suppose the company's plant is carried on the books at a depreciated value of \$5 million, but, in reality, it is obsolete and in poor condition. The buyer would have to spend \$10 million to modernize it. What looked like a \$5 million asset is really a \$5 million liability, which should be reflected in the projected cash flows.

Or suppose the plant sits on a former hazardous waste dump. The future cleanup costs are not shown as liabilities. Future product liability suits will not be shown, although pending litigation should be footnoted on the balance sheet. In California, sellers and everyone associated with selling a business, such as brokers and accountants, must disclose all known potential liabilities about the business.

People wonder why the buyers of the Hollywood studios paid so much for what looked to be mostly assets such as real estate and equipment. The hidden values of those firms were their huge film libraries that would bring in future rentals. Ted Turner wanted MGM's films, not the company or its studios.

Astute entrepreneurs start their ventures with the goal of building up off balance sheet items to raise the cash value of their businesses. Most sophisticated buyers examine the proprietary aspects of a business they are considering buying.

### Off Balance Sheet Checklist

Advertising campaigns	Employment contracts	Litigation awards	Sources of supply
Advertising materials	Engineering drawings	Location	Subscription lists
Backlogs	Environmental rights	Mailing lists	Supplier contracts
Computer databases	Favorable financing	Manuscripts	Systems and procedures
Computer designs	Formulas	Mineral rights	Technical documentation
Computer software	Franchises	Non-compete covenants	Tooling
Contracts	Government programs	Packaging	Trade secrets
Copyrights	Joint ventures	Patents and applications	Trademarks
Credit files	Know-how	Permits	Training procedures (manuals)
Customer base	Laboratory processes	Proprietary designs	Unpatented technology
Customer lists	Leasehold interests	Rights	Use rights (air, water, land)
Distribution channels	Libraries	Royalty agreements	Work force
Distributorships	Licenses	Schematics and diagrams	
Easements	Literary works		

Source: The Geneva Companies, Irvine, California

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